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WM. R. STANS
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Supreme Court of the United States

OCTOBER TERM, 1921.

No.....

WALLACE BENEDICT as Receiver in Bankruptcy of the Hub Carpet Company,

Petitioner,

against

AARON RATNER,

Respondent.

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT OF PETITION.

SELDEN BACON,
Counsel for Petitioner,
43 Exchange Place,
New York City.

1

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PLEASE TAKE NOTICE that the annexed petition for a writ of *certiorari* to the United States Circuit Court of Appeals for the Second Circuit, and the annexed brief in support thereof, together with a certified copy of the record on appeal to the Circuit Court of Appeals and of the record of that Court, will be submitted to the Supreme Court of the United States at the Capitol at Washington in the District of Columbia, at the opening of court on the 29th day of May, 1922, or as soon thereafter as counsel can be heard.

3

Dated, May 4th, 1922.

SELDEN BACON,
Counsel for Petitioner,
43 Exchange Place,
New York City.

To:
LOUIS S. POSNER, Esq.,
Counsel for Respondent.

4 **Supreme Court of the United States**

WALLACE BENEDICT as Receiver in Bankruptcy of the Hub Carpet Company, Petitioner, against AARON RATNER, Respondent.	October Term, 1921.

PETITION FOR CERTIORARI.

5 *To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:*

Your petitioner, Wallace Benedict, as Receiver and Trustee in Bankruptcy of the Hub Carpet Company, respectfully shows:

First: That the Hub Carpet Company is a New York corporation which was doing business in the City of New York from January 1st until September 26th, 1921, on which latter date your petitioner was duly appointed receiver in bank-
6 ruptcy of the Hub Carpet Company and duly qualified as such. That thereafter and on the 17th day of October, 1921, said Hub Carpet Company was adjudicated a bankrupt and thereafter, to wit, on the 25th day of November, 1921, your petitioner was duly elected and qualified and ever since has been the Trustee in Bankruptcy of said Hub Carpet Company.

Second: Your petitioner further shows that on 7
the 19th day of October, 1921, the above named Aaron Ratner filed his petition in equity in the United States District Court for the Southern District of New York asserting that all the accounts receivable of the bankrupt, both present and future, had been assigned to him on May 23rd, 1921, by the bankrupt corporation as collateral security for loans previously made and to be thereafter made by him, which amounted to $30,000 and interest. That it appeared that the said assignment was executed under an oral contemporaneous agreement that the bankrupt might go on collecting its receivables and using the pro- 8
ceeds thereof in its business until the assignee of the receivables should call on it to turn over the proceeds of the receivables to him, and the assignment itself contained the following two clauses:

> "We, the Hub Carpet Company, further covenant and agree to fully disclose our business and financial conditions at any time the said Aaron Ratner so demands and hereby authorize him to enforce this assignment at any time that in his judgment it may be for his interest to do so notwithstanding the time for the payment of the notes has not in fact accrued.
>
> We further covenant and agree with the 9
> said Aaron Ratner on demand to turn over to the said Aaron Ratner any and all payments made to us by our debtors and to be applied by him in payment of any obligations due him, notwithstanding that the time for the payment of said obligations held by him at that time has not in fact become due and payable."

10 The respondent did not ask to have the accounts turned over to him until the 17th day of September, 1921, and meantime the bankrupt had collected and used in its own business for its own purposes over $150,000 proceeds of accounts covered by the assignment. The claimant Mr. Ratner testified with regard to the arrangement for his security as follows:

> "They told me they wanted, they could not, it would be kind of compromising themselves to be giving away the checks, somebody should collect it and they could not do it; so they said that they could do it providing they made arrangements that they should be able to
11 keep on collecting the checks and everything until I will find it advisable then I should call it in, but as long as I do not find it advisable in any way or manner nobody should know about it and they should keep on collecting the checks.
>
> "Q. And using the money? A. And using the money, certainly."

It was claimed by your petitioner, the Receiver and Trustee in bankruptcy of the assignor, that an arrangement of this character rendered the assignment fraudulent and void as to him and as to the creditors whose interests he represented.

It was insisted by the claimant, Mr. Ratner, that
12 the arrangement made was in no way actually fraudulent and that the same was not in law fraudulent, on the sole ground that the assignment was exclusively of non-tangible receivables and not of personal property subject to manual possession.

The doctrine was laid down by this Court in 13
Robinson vs. *Elliott,* 22 Wall. 513, 526, at pages 523 to 526 that an agreement that a mortgagor under cover of a mortgage, might go on and sell the goods as his own, and appropriate the proceeds to his own purposes, shielded the property of the debtor, so that creditors would be delayed in the collection of their debts, and made the instrument fraudulent.

In the present case it has been held below, that that rule is predicated exclusively on manual possession of tangible property, and a consequent appearance of ownership growing out of such physical possession, and was inapplicable to intangible 14
property. This constitutes the central question in the case.

Your petitioner contends that the doctrines of *Robinson* vs. *Elliott,* 22 Wall. 513; of *Russell* vs. *Winne,* 37 N. Y. 591; *Skilton* v. *Coddington,* 185 N. Y. 80; *Griswold* v. *Sheldon,* 4 N. Y. 581; *Southard* v. *Benner,* 72 N. Y. 424; *Zartman* v. *First National Bank,* 189 N. Y. 267; and *In re Leslie-Judge Company,* 272 Fed. Rep. 886, as to such provisions, are not limited in their application to property capable of manual possession, but apply equally to intangible property; and that the vice of such transactions lies in this: that there is in fact no real 15
transfer, no real vesting of title in the assignee but such an arrangement whereby the title and authority of the assignor are to be unrestricted as long as he is able to shunt along his business, but that whenever a crash comes, then by some sort of legerdemain the written assignment is to be stimulated into life to prefer the claim of the assignee, is equally a fraud whether applied to chattels or

16 to choses in action; and that a transfer which at one time places no bar to the ownership of the assignor and in another exigency is intended to be absolute, is invalid as a fraud irrespective of manual possession, and cannot be upheld against creditors seeking an equal distribution of all the assets of the bankrupt.

Your petitioner urges that the fraudulent character of the instrument is just as real in the case of receivables, as it is in the case of tangible property, and the inherent fraudulent element is the same in the one case as in the other, and is not dependent upon any appearance of ownership
17 flowing from manual possession.

Your petitioner urges that all decisions holding that recorded *chattel* mortgages containing such clauses are void, are decisions that the physical possession of the property is not the determining element. Any impropriety arising from continued physical possession of the property is prevented by recording the instrument, but the same nevertheless remains void for the fraud. *Ergo,* the fraud does not arise out of the appearance of title created by possession.

The Circuit Court of Appeals sustained all the contentions of the claimant and held here that such provisions do not affect the validity of an assign-
18 ment of receivables, whereas in the case of *In re Leslie-Judge Company,* 272 Fed. Rep. 886, it held that a provision in a chattel mortgage allowing the sale of parts of a plant which had become useless and use of the proceeds thereof by the mortgagor, constituted fraud in law and invalidated the instrument even as to intangible articles assigned by its provisions.

Your petitioner is advised that said decree of the Circuit Court of Appeals is erroneous and that this Honorable Court should require the case to be certified to it for its review and determination under the Act of Congress permitting equity proceedings arising in bankruptcy proceedings, otherwise made final in the Circuit Court of Appeals, to be certified to this Court for review. Your petitioner shows that the said Circuit Court of Appeals erred in holding that the said assignment was fraudulent.

Your petitioner further shows that said Circuit Court of Appeals erred in holding that the principle that provisions for continuing to handle the property as the assignor's own, and to use the proceeds for its own purposes, render assignments fraudulent, is applicable only in the case of assignments of tangible property and by reason of the appearance of ownership flowing from possession.

Your petitioner shows that the Circuit Court of Appeals also erred in holding that such assignment was an effective security from the day of its execution.

General Reasons For Allowance of Writ.

The decision below is that provisions in an assignment of receivables, made for purposes of collateral security, covering all present and future receivables of the assignor, that the assignor shall go on collecting the receivables and using the proceeds in its business until notified by the assignee to turn them over to him do not render

such an assignment fraudulent as against the creditors of the assignor, though unquestionably they would have such effect on a chattel mortgage.

If this ruling is correct, it affects most seriously the whole commercial credit system of the country.

It is believed that this ruling is in conflict with the decision of this court in *Robinson* vs. *Elliott,* 22 Wall. 513, 523-536, and with numerous decisions of the New York Court of Appeals cited below.

The decision at bar is distinguished by the Court below from a prior decision of its own holding a chattel mortgage void (*In re Leslie-Judge Company* case, 272 Fed. Rep. 886), solely by the fact that all the property covered by the assignment here was receivables and intangible, while in that case a minor part of the property was tangible.

The present decision in the Circuit Court of Appeals is, according to our view, in conflict with the principles established by this Court in *Robinson* vs. *Elliott,* 22 Wall. 513, and is also in conflict with the principles laid down in the following New York cases:

Russell v. *Winne,* 37 N. Y. 591;
Skilton v. *Codington,* 185 N. Y. 80, 90;
Griswold v. *Sheldon,* 4 N. Y. 581, 588-590;
Southard v. *Benner,* 72 N. Y. 424;
Zartman v. *First Natl. Bank,* 189 N. Y. 267.

The case of *Stackhouse* v. *Holden,* 66 A. D. 423, holding to the contrary was by an intermediate appellate New York court, and was a decision

rendered by three judges with two judges dissenting, the latter in a most vigorous opinion written by Justice Spring. That decision does not established the law of New York as against the repeated decisions and opinions of the Court of Appeals. 25

It has not been understood at the bar that this rule as to fraud was limited as held below in the present case. If that fact becomes generally understood scarcely a bankruptcy will come into the courts without the appearance of such an assignment of the receivables. The matter is, therefore, of public importance, not only affecting seriously the credit office of every business house in the country, but also as likely to affect numberless cases in the bankruptcy courts; and a definite and final decision with regard to this doctrine should be made by this Court. 26

The question presented is a square question of common law and that question of law has been squarely decided in both courts below. The amount involved here is but $30,000 but the decision as affecting business relations of the community and the administration of the Bankrutpcy Law is of the most far reaching importance.

Facts.

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The evidentiary facts are practically undisputed.

The claimant, Ratner, presented an affidavit and order to show cause alleging that an assignment had been made to him by the bankrupt, four months and three days before the filing of the petition in bankruptcy, of all its receivables, pres-

ent and future, as collateral security for loans, and a prayer that the bankrupt and the receiver turn over to the claimant Ratner the receivables of the bankrupt and any moneys collected thereon until his claim of $30,000 with interest was satisfied.

Ratner, during the last ten days preceding the filing of the petition in bankruptcy, had demanded that the proceeds of the receivables be delivered to him under this assignment. During that week he received in cash or checks $11,581.75 and in notes and trade acceptances (which he had not up to that time been able to collect), $2,212.66 more. Disregarding the last item, he claimed there was a balance due him of $18,418.25. He annexed to his petition a copy of the instrument under which he claimed, which contained the clauses quoted above.

The receiver showed cause that the assignment was admittedly affected by a contemporaneous express collateral agreement that the bankrupt, despite the assignment, should be allowed to continue to collect its receivables and use the proceeds in the course of its business until the petitioner should become disturbed about recovering his claim and demand that the proceeds of the receivables be turned over to him. Provisions for such demand appeared in the assignment itself. The claimant Ratner personally gave the following account of the transaction:

> " * * * They told me they wanted, they "could not, it would be kind of compromis- "ing themselves to be giving away the checks, "somebody should collect it and they could

"not do it; so they said that they could do 31
"it providing they made arrangements that
"they should be able to keep on collecting
"the checks and everything until I will find
"it advisable then I should call it in, but as
"long as I do not find it advisable in any
"way or manner nobody should know about it
"and they should keep on collecting the
"checks.

"Q. And using the money? A. And using "the money, certainly" (fols. 141-142, as corrected by stipulation).

Your petitioner further showed that the receivables did so remain in possession of the bankrupt from the delivery of the assignment, which was 32
asserted by the petitioner to have been made on the 23rd day of May, 1921, until the 17th of September, 1921, the bankrupt during that period collecting and using over $150,000 out of such (allegedly) assigned receivables with the consent of the assignee, Mr. Ratner, and the Receiver claimed that the assignment of the receivables was consequently fraudulent and void.

Whether any of the remaining receivables or any of those collected by or turned over to Ratner during the week preceding the appointment of the receiver had existence at the time the assignment was made, in May, 1921, or were then future re- 33
ceivables, was wholly undisclosed by the record. Mr. Ratner testified that the receivables on May 23rd amounted to between $110,000 and $120,000; that on September 17th the total of receivables had been reduced to $90,000. It was undisputed that $150,000 of receivables had been collected and used by the bankrupt in its business between May

23rd, 1921, and September 17th, 1921, with Ratner's consent.

The petition in bankruptcy was filed and the Receiver appointed on September 26th, 1921.

The Receiver also claimed that if the assignment was galvanized into life by the delivery of the collections to Ratner during the last week before the bankruptcy, that galvanization could affect only the $12,000 paid over to him, and even as to that it would be preferential.

The District Court and the Circuit Court both held that under these conditions, concerning which there was no dispute, the assignment was entirely valid as against the creditors of the bankrupt, and the receiver and trustee, and have not only sustained Ratner's claim to the $12,000 received by him, but have ordered the Receiver and Trustee to pay $18,000 more to Ratner to satisfy his lien, as a first claim.

Your petitioner presents herewith a certified copy of the transcript of record returned from the District Court to the Circuit Court of Appeals and of the record in the last-named Court.

WHEREFORE, your petitioner prays that a writ of certiorari may be issued out of and under the seal of this Court directed to the United States Circuit Court of Appeals for the Second Circuit, requiring said Court to certify and send to this Honorable Court on a day certain, to be therein designated, a full and complete transcript of the record and proceedings of said Circuit Court of Appeals in the cause therein entitled In the Matter of Hub Carpet Company, Bankrupt, Ex-parte Aaron Ratner, Appellee, Wallace Benedict as Receiver in Bankruptcy of Hub Carpet Company,

Appellant; to the end that the said cause may be 87
reviewed and determined by this Court as provided by law, and that your petitioner may have such other and further relief in the premises as to this Court may seem just.

WALLACE BENEDICT,
As Receiver and Trustee in Bankruptcy of Hub Carpet Company, Bankrupt.

SELDEN BACON,
Solicitor and Counsel for Receiver and Trustee.

SOUTHERN DISTRICT OF NEW YORK, }
CITY AND COUNTY OF NEW YORK, } ss.:

88 WALLACE BENEDICT, being duly sworn, deposes and says: That he is the petitioner herein in the making of the foregoing petition; that he has read the same and knows the contents thereof, and that the same is true to the best of his knowledge, information and belief.

WALLACE BENEDICT.

Sworn to before me this 4th day of May, 1922.

WM. G. PHILLIPS,
(Notarial Seal) Notary Public,
Kings Co., N. Y. No. 35.
Certificate filed in N. Y. Co. No. 76.
Kings Co. Register's No. 4033.
N. Y. Co. Register's No. 4103.

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I hereby certify that the foregoing petition is presented in good faith and not for the purpose of delay, and that in my opinion the case is a proper one for the issue of the writ of certiorari prayed for.

SELDEN BACON,
Of Counsel.

INDEX OF POINTS.

I.

The Circuit Court of Appeals erred in holding that the doctrine—that an agreement that an assignment of property as collateral security to secure the assignee for a debt due him from the assignor, which provides that the assignor may use and dispose of the property as his own and use the proceeds in his business until the assignee shall determine to take possession of the property, makes the assignment fraudulent,—applies only in the case of tangible property and has no application to an assignment of accounts receivable.

p. 6.

II.

The decisions in Sexton v. Kessler, 225 U. S. 90, and in Chapman v. Hunt, 254 Fed. Rep. 768, in no way conflict with the rule we invoked.

p. 13.

III.

Even were the rule predicated on a false appearance of ownership, the facts here supply the equivalent and more than the equivalent of any false appearance of ownership arising from possession of tangibles. There was the actual appearance of ownership deliberately preserved and sustained, and deliberate concealment of the assignment to avoid the obvious and contemplated consequences of disclosure of the fact of the assignment of all receivables present and future.

p. 15.

IV.

If the assignment was galvanized into actuality by Ratner's taking over the checks as they came in, during the last week before the bankruptcy, that galvanization process went no further than his actual receipts of about $12,000, and the decree for further payment to him of some $18,000. is erroneous. Moreover as to the $12,000 the transaction was preferential.

p. 17.

V.

The main question presented is of the utmost importance to the business community and to the administration of the Bankruptcy Act.

p. 18.

VI.

The petition should be allowed and the writ be issued.

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Supreme Court of the United States

WALLACE BENEDICT as Receiver in Bankruptcy of the Hub Carpet Company, Petitioner, against AARON RATNER, Respondent.	October Term 1921

BRIEF FOR PETITIONER FOR WRIT OF CERTIORARI.

The question presented by this case is an extremely simple one based on facts practically undisputed and is this:

The rule is well established, both in the Federal Courts and in the Courts of the State of New York, that a chattel mortgage, containing a provision that the mortgagor may dispose of the property and use the proceeds for his own purposes, without accounting to the mortgagee, is fraudulent and void as against creditors, even though it be recorded.

This rule applies equally whether the provision be incorporated in the instrument or collateral thereto.

Frost v. *Warren*, 42 N. Y. 204;
Gardner v. *McEwen*, 19 N. Y. 123.

Does this doctrine apply exclusively in the case of tangible property, the subject of manual possession, left in the possession of the owner, or will

it apply also to an assignment exclusively of receivables, present and future, for purposes of collateral security?

The Court below has held that the rule is predicated on the appearance of ownership flowing from possession and that there can be no such appearance of ownership flowing from possession in the case of receivables because they are not the subject of manual possession.

The evidentiary facts were undisputed and the question is one of pure law.

The resultant rule is of the most widespread interest in the commercial world and we believe it would be in flat contradiction of the doctrines announced by this court in *Robinson* vs. *Elliot,* where, in stating that principle, this court apparently did not derive it from any matter of appearance of possession, but from the inherent duplicity of such an instrument, which is valid as a chattel against his creditors when the debtor wants it to be and of no validity when he wants to use the proceeds himself, and we understand the decisions of the New York Court of Appeals to hold that same doctrine.

The facts are these:

A petition in bankruptcy was filed against the Hub Carpet Company, the above named bankrupt, on the 26th day of September, 1921, and Mr. Benedict was immediately appointed receiver and qualified.

Immediately upon his taking possession of the property, Mr. Ratner, the claimant, presented an assignment to him of all receivables, present and future, of the Company, dated May 23rd, 1921, four months and three days prior to the filing of

the petition in bankruptcy, and stated that at the time the assignment was made, he renewed a loan of $15,000 to the corporation and about the first of July loaned them $15,000 additional, and that this debt was unpaid, except that during the week preceding the bankruptcy proceeding, there had been turned over to him some $12,000 of collections.

Prior to that time and since the assignment, the bankrupt with Ratner's consent had collected and used for its own purposes over $150,000. The total receivables at the time the assignment was made were less than $120,000 and a week before the bankruptcy, when the bankrupt began to turn the collections over to Mr. Ratner, were but about $90,000. Whether any of the receivables in existence on the 17th of September were in existence on the 23rd of May or had passed by the assignment of future receivables was undisclosed.

The assignment contained the two following clauses:

> "We, the Hub Carpet Company, further "covenant and agree to fully disclose our "business and financial conditions at any time "the said Aaron Ratner so demands and here-"by authorize him to enforce this assignment "at any time that in his judgment it may be "for his interest to do so notwithstanding the "time for the payment of the notes has not in "fact accrued.
>
> "We further covenant and agree with the "said Aaron Ratner on demand to turn over "to the said Aaron Ratner any and all pay-"ments made to us by our debtors and to be "applied by him in payment of any obliga-"tions due him, notwtihstanding that the "time for the payment of said obligations

"held by him at that time has not in fact "become due and payable." (Record, fols. 32-33).

And the claimant and his son, the official of the bankrupt who negotiated the arrangement with him, respectively gave the following testimony:

The son testified:

"We worked out the best way to secure him "without affecting us personally, that is by "not having him collect accounts or anything "of that sort." (Record, fol. 104.)

and again:

"We told him that we would not under any "conditions have him make our collections for "us, do you see, and one of the stipulations "was that we were to collect them." (Record, fol. 108.)

The claimant Aaron Ratner testified:

"They told me they wanted, they could not, "it would be kind of compromising themselves "to be giving away the checks, somebody "should collect it, and they could not do it, "so they said they could do it, providing they "made arrangements that they should be able "to keep on collecting the checks and every-"thing until I will find it advisable then I "should call it in but as long as I do not find "it advisable in any way or manner, nobody "should know about it and they should keep "on collecting the checks.

"Q. And using the money? A. And using "the money, certainly" (fols. 141-142, as corrected by stipulation on file).

Upon this state of facts, the receiver claimed that the assignment was fraudulent and void as against the creditors and hence Mr. Ratner brought his petition in equity in the bankruptcy proceeding, demanding that the court order the receiver (and trustee as he became) to pay over the balance necessary to satisfy his lien, a matter of some $18,000. The receiver resisted this application, on the ground that the assignment was fraudulent and void; that it was fraudulent in law and the declared intention of the parties to keep the matter secret made it actually fraudulent, and prayed that Ratner be required to return the $12,000 turned over to him pursuant to the assignment just before the bankruptcy.

The District Court held that the assignment was not fraudulent but valid, on the ground that the rule that such contracts are fraudulent and void as against creditors was predicated exclusively on the appearance of ownership flowing from possession of the property, and directed the receiver and trustee to turn over the receivables to the claimant, Mr. Ratner, to an amount sufficient to satisfy his claim, sustaining that claim as a prior lien.

That decision was unanimously affirmed by the Circuit Court of Appeals on the same ground; the court holding that the agreement would unquestionably have rendered the assignment void had it been one of tangible property, but had no such effect on an assignment of receivables not capable of manual possession.

POINT I.

The Circuit Court of Appeals erred in holding that the doctrine—that an agreement that an assignment of property as collaterial security to secure the assignee for a debt due him from the assignor, which provides that the assignor may use and dispose of the property as his own and use the proceeds in his business until the assignee shall determine to take possession of the property, makes the assignment fraudulent,—applies only in the case of tangible property and has no application to an assignment of accounts receivable.

In re Leslie-Judge Co., 272 Fed. Rep. 886;
Russell v. *Winne*, 37 N. Y. 591;
Skilton v. *Codington*, 185 N. Y. 80, 90;
Griswold v. *Sheldon*, 4 N. Y. 581, 588-590;
Southard v. *Benner*, 72 N. Y. 424;
Zartman v. *First Natl. Bank*, 189 N. Y. 267;
In re Volence, 197 Fed. Rep. 232;
Robinson v. *Elliot*, 22 Wall. 513, 525-527.

We think an examination of these cases, and others, shows clearly that the basic principle of this rule is not predicated on any appearance of ownership of the property growing out of its physical possession, but on the two-faced character of the

instrument, making it a shield of the debtor's property against his other creditors, while leaving it no obstacle to the debtor's using his property as he will, and the fact that an instrument so qualified is not a real security but is intended for ulterior and fraudulent purposes and operates in fraud of creditors.

It seems to us that the learned court below has confused two independent principles, though frequently both apply to a single transaction. There is a rule that is based on such appearance of ownership growing out of continued possession. It is the familiar one, now limited by statutes, so that *unrecorded* chattel mortgages are void (in many States only against creditors or purchasers *without notice*) where the mortgagor remains in continued possession. *That* statutory rule unquestionably found its origin in the fact that the mortgagor is clothed by possession with a fallacious appearance of title. And provisions for recording chattel mortgages were devised to remove that appearance and to cure that defect by giving notice, while saving the advantages of honest mortgages (22 Wall. 523).

Decisions holding that such agreements as we are here considering do avoid mortgages, even though they be recorded, and even though the mortgagee takes and holds possession of the property can not rest on any such principle of apparent ownership, growing out of physical possession, but on some other and different basic principle, not cured by removing that appearance.

Cases implying that the rule is not based on any appearance of ownership growing out of possession but on the fraudulent character of the arrangement we find in abundance.

Robinson v. *Elliott,* 22 Wall, 513, 525-527;
Russell v. *Winne,* 37 N. Y. 591;
Griswold v. *Sheldon,* 4 N. Y. 581, 590;
Southard v. *Benner,* 72 N. Y. 424;
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In re Marine Construction Co., 144 Fed. 649;
In re Leslie-Judge Co., 272 Fed. Rep. 886;
Worrall v. *Smith,* 1 Camp. 322;
Paget v. *Perchard,* 1 Esp. 205.

And we find in these cases statements of a totally different principle as the basis of the rule here invoked, and one suspectible of no such distinction as the court below drew.

> "If there is an agreement by the mortgagee that the mortgagor may sell or dispose of any of the property for his own benefit, it is established, conclusively, that the mortgage was given for some purpose other than that of securing a debt to the mortgagee, or of giving him any real interest in such property. It is evident that, as to such property, the mortgagee not having any real interest therein, such real interest remains in the mort-

> gagor. Why, then, is the mortgage given upon such property? Evidently the better to enable the mortgagor to enjoy the benefit thereof, at the expense of creditors. Were there no creditors of the mortgagor, there would be no object in giving or taking mortgages accompanied with such an agreement. It is, I think, clear that such an agreement shows that the mortgage was not made in good faith and without a design to hinder creditors. There is no question of intention to be submitted to a jury. It already appears that, as to such property, the mortgage was not designed by the parties as an operative instrument between them; and its only operation must be to the prejudice of others. The court should as to such property, pronounce it void, for the reason that the evidence conclusively shows it fraudulent."
>
> *Russell v. Winne,* 37 N. Y. 591, 594-595.

This, we believe, states the real principle back of the rule we have invoked. It leaves no room for any such distinctions as the judges below drew between tangible and intangible property. Sheltering intangible property for the debtor, enabling him to dispose of it, is just as fraudulent and just as prejudicial as the like duplicity with regard to tangible property.

The leading case is *Robinson* v. *Elliott,* 22 Wall. 513.

As we read the opinion in that case this Court there declared the mortgage in question void on two independent grounds, the first, the fraudulent appearance of ownership, the second, expressly pointed out by the words "apart from this" as a wholly independent ground, that the

mortgage permitted the mortgagors under cover of the mortgage to fend off creditors from seizing the property and at the same time to sell the goods and appropriate the proceeds as their own.

We may be permitted to quote two extensive passages from the opinion, as they seem to us to have been misconstrued by the Court below.

At page 523 this Court said:

> "If chattel mortgages were formerly, in most of the States, treated as invalid unless actual possession was surrendered to the mortgagee, it is not so now, for modern legislation has, as a general thing (the cases to the contrary being exceptional) conceded the right to the mortgagor to retain possession, if the transaction is on good consideration and bona fide. This concession is in obedience to the wants of trade, which deem it beneficial to the community that the owners of personal property should be able to make bona fide mortgages of it, to secure creditors, without any actual change of possession.
>
> *"But the creditor must take care in making his contract that it does not contain provisions of no advantage to him, but which benefit the debtor, and were designed to do so, and are injurious to other creditors. The law will not sanction a proceeding of this kind. It will not allow the creditor to make use of his debt for any other purpose than his own indemnity. If he goes beyond this, and puts into the contract stipulations which have the effect to shield the property of his debtor, so that creditors are delayed in the collection of their debts, a court of equity will not lend its aid to enforce the contract."*

And at pages 525-526 this Court added:

"Manifestly it was executed to enable the mortgagors to continue their business and appear to the world as the absolute owners of the goods, and enjoy all the advantages resulting therefrom. It is idle to say that a resort to the record would have shown the existence of the mortgage, for men get credit by what they apparently own and possess, and this ownership and possession had existed without interruption for ten years. There was nothing to put creditors on their guard. On the contrary, this long-continued possession and apparent ownership were well calculated to create confidence and disarm suspicion.

But, ***apart from this,*** *security was not the leading object. If so, why does Mrs. Sloan's note remain overdue for twenty-one months, and why does Robinson continue to indorse? This conduct is the result of trust and confidence, which as Lord Coke tells us, are ever found to constitute the apparel and cover of fraud.*

In truth, the mortgage, if it can be so called, is but an expression of confidence, for there can be no real security where there is no certain lien.

Whatever may have been the motive, which actuated the parties to this instrument, it is manifest that the necessary result of what they did do was to allow the mortgagors under cover of the mortgage, to sell the goods as their own, and appropriate the proceeds to their own purposes; and this, too, for an indefinite length of time. A mortgage which, in its very terms, contemplates such results, besides being no security to the mortgagees, operates in the most effectual manner to ward off other creditors; and where the instrument

> *on its face shows that the legal effect of it is to delay creditors, the law imputes to it a fraudulent purpose."*
>
> *Robinson* v. *Elliott,* 22 Wall. 513, 523, 525-526.

We find nothing in the case that intimates that appearance of ownership growing out of visible possession is necessary to give to such an arrangement the effect to delay creditors, rendering it fraudulent.

The only other case that seems to call for attention is the decision in *Stackhouse* vs. *Holden,* 66 A. D. 423 a three to two decision in the Appellate Division of the Fourth Department of the State of New York. That Court is, of course, an intermediate Court of Appeal and the decision cannot be regarded as settling the law for the State of New York in conflict with the cases in the Court of Appeals which we have cited. We call attention to the dissent of Justices Spring and Adams, and to the vigorous statement in the dissenting opinion, following exactly the lines of the decision in this Court in *Robinson* vs. *Elliott.*

> "The vice here is that there was in fact no real transfer, no real vesting of title in the assignee. It was an arrangement whereby the title and authority of Humphrey & Holdridge were to be unrestricted as long as they were able to shunt along their business, but whenever the inevitable cash came, then by some sort of legerdermain the written instrument was to be stimulated into life to prefer the overdraft of the defendant. *A transfer which at one time places no bar to the ownership of the assignor, and in another exigency*

is intended to be absolute, cannot be upheld against the creditors who are seeking an equal distribution of all the assets of the bankrupt assignors."

Stackhouse v. *Holden,* 66 A. D. 423, 433.

POINT II.

The decisions in *Sexton* v. *Kessler*, 225 U. S. 90, and in *Chapman* v. *Hunt*, 254 Fed. Rep. 768, in no way conflict with the rule we invoked.

The Circuit Court of Appeals agreed with us that the situation presented in those cases differed in principle from the situation presented here.

In *Sexton* v. *Kessler,* 225 U. S. 90, there was no such feature as exists here of allowing the pledgor to withdraw pledged securities, without substituting therefor other securities of equal or greater value, not previously included in the pledge.

This Court expressly distinguished from that case two New York cases holding that security would fail where the mortgagor retained full power to replace or not as he saw fit, and pointed out that the case before it "was a more limited "and cautious dealing giving an absolute present "right, qualified only by possible substitution and "perhaps by a right of partial withdrawal if the "remaining securties had risen sufficiently in "value" (225 U. S. 98).

In the case at bar every receivable might have been collected and the proceeds used without any new receivable arising.

Moreover, if any new receivable did arise and were assigned it would not be a substitution or a new consideration, for it was to be included on its own account by the very terms of the instrument, irrespective of any collections having been made. Nor was there even any agreement to keep the receivables up to an amount equal to the original amount.

The other case, *Chapman* v. *Hunt,* 254 Fed. Rep. 768, likewise contained the vital feature that only certain specific accounts of limited amount were assigned to Hunt as collateral, and the Candy Works was permitted to receive the proceeds of any such assigned account only "upon assigning "to Hunt an equal amount of new accounts, so "that he should be always secured in the sum of "$6,000."

There was there no such situation of a general leave to the assignor to collect and use the proceeds of the assigned receivables irrespective of any replacement or substitution of others therefor, and without new consideration or provision for any new security whatever.

In both the *Sexton* and the *Hunt* cases there was the vital feature of a new consideration for the withdrawal, and neither transaction bore the two faced character of *not* being an assignment when the assignor wanted to use the property, and being one when his creditors wanted to take the property.

Neither case is parallel to the present. Neither case opened the door to the innumerable frauds to which the decision below throws all doors open.

POINT III.

Even were the rule predicated on a false appearance of ownership, the facts here supply the equivalent and more than the equivalent of any false appearance of ownership arising from possession of tangibles. There was the actual appearance of ownership deliberately preserved and sustained, and deliberate concealment of the assignment to avoid the obvious and contemplated consequences of disclosure of the fact of the assignment of all receivables present and future.

In the statement of facts we have called attention to the statements of Ratner to the specific discussion in the original transaction of the purpose that the existence of the assignment should not become known.

Young Ratner, who acted for the Hub Carpet Co. in the transaction, testified:

> "We worked out the best way to secure him without affecting us personally, that is, by not having him collect accounts or anything of that sort" (fol. 104).
>
> "We told him that we would not under any conditions have him make our collections for us, do you see, and one of the stipulations was that we were to collect them" (fol. 108).

And the petitioner Ratner himself testified:

> "They told me they wanted, they could not, it would be kind of compromising themselves, to be giving away the checks, somebody should

collect it and they could not do it; so they said that they could do it providing they made arrangements that they should be able to keep on collecting the checks and everything until I will find it advisable, then I should call it in, *but as long as I do not find it advisable in any way or manner nobody should know about it and they should keep on collecting the checks.*

Q. *And using the money?* A. *And using the money, certainly"* (fols. 141-142, as corrected by stipulation).

The Court needs no information as to the immediate consequences to a business house of having the fact become known that it had assigned all its receivables present and future as collateral. Those consequences these parties deliberately tried to avoid by keeping the assignment secret, and allowing the Hub Carpet Co. to go on collecting its receivables and using the proceeds in its business.

By concealing the assignment they staved off bankrutpcy till three days more than four months after execution of the assignment.

If the item of possession of chattels giving an appearance of ownership is a material one to the rule we have invoked, the deliberate and intentional arrangement that the Hub Carpet Co. should go on collecting its receivables and using them in its business for the express purpose of preventing any information of the assignment leaking out, is its full legal equivalent.

If the constructive representation of continued ownership growing out of continued possession of tangibles furnishes a needed element in the one case, is its place not fully taken by deliberate

concealment of the assignment and continued collection of the receivables by the assignor with the express purpose of conveying the impression that there had been no assignment? Any one can see that the Hub Carpet Co. maintained its credit after May 23rd, 1921, only by the appearance of owning its receivables.

Is there not here the full equivalent of every element of fraud suggested in *Robinson* v. *Elliott*, 22 Wall. 513, and in *Blennerhasset* v. *Sherman*, 105 U. S. 100? And is not this assignment fraudulent and void at Common Law?

POINT IV.

If the assignment was galvanized into actuality by Ratner's taking over the checks as they came in, during the last week before the bankruptcy, that galvanization process went no further than his actual receipts of about $12,000, and the decree for further payment to him of some $18,000 is erroneous. Moreover as to the $12,000 the transaction was preferential.

This feature of the case has not the general importance of the question we present as a ground for the issue of the writ. We mention the fact merely as an additional feature that will be presented if the writ is allowed.

POINT V.

The main question presented is of the utmost importance to the business community and to the administration of the Bankruptcy Act.

If the decision below correctly states the law, the effect on the credit department of every business house is going to be immediate. No credit man can know what reliance to place upon statements of assets and liabilities. They may be subject to all sorts of concealed assignments of the receivables, which notably constitute a most important item of quick assets, on which allowances of credit are based. The decision below opens the door wide for fraud.

As an actual fact under modern business conditions, especially in large cities, where stocks of goods are carried in warehouses and represented only by warehouse-men's receipts, there is just as much appearance of possession and ownership in the case of receivables as there is in the case of tangible property in storage.

No reason is seen why a shelter that is fraudulent as to one kind of property because it is an assignment when the assignor wants it to be an assignment and not an assignment when he doesn't want it to be, is not just as much a fraud as to another kind of property.

> "The law will not sanction a proceeding of this kind. It will not allow the creditor to make use of his debt for any purpose other

than his own indemnity. If he goes beyond this, and puts into the contract stipulations which have the effect to shield the property of his debtor so that creditors are delayed in collection of their debts, a court of equity will not lend its aid to enforce the contract."

Robinson vs. *Elliott,* 22 Wall. 513, 523.

"Whatever may have been the motive which actuated the parties to this instrument, it is manifest that the necessary result of what they did do was to allow the mortgagors under cover of the mortgage, to sell the goods as their own, and appropriate the proceeds to their own purposes; and this, too, for an indefinite length of time. A mortgage which, in its very terms, contemplates such results, besides being no security to the mortgagees, operates in the most effectual manner to ward off other creditors; and where the instrument on its face shows that the legal effect of it is to delay creditors, the law imputes to it a fraudulent purpose."

Robinson v. *Elliott,* 22 Wall. 513, 523, 525-526.

The decision below conflicts with those statements of the law.

POINT VI.

The petition should be allowed and the writ be issued.

In view of the great importance to the business community and to the administration of the bankruptcy act of a definite settlement of this question, and of the conflict between the main point of the decision below and the doctrines announced by this Court in *Robinson* v. *Elliott,* 22 Wall. 513, we urge that the case is one where the writ should issue and the point of law definitively determined.

Respectfully submitted,

SELDEN BACON,
Solicitor and Counsel
for Petitioner.

FILED
FEB 14 1923
WM. R. STANSBURY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1922.

No. 411

WALLACE BENEDICT, as Receiver in Bankruptcy of The Hub Carpet Company,

vs.

AARON RATNER.

(ON WRIT OF CERTIORARI.)

BRIEF FOR WALLACE BENEDICT, AS RECEIVER.

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New York, N. Y.

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Supreme Court of the United States

OCTOBER TERM, 1922.

No. 400.

WALLACE BENEDICT, as Receiver in Bankruptcy of The Hub Carpet Company, vs. AARON RATNER.	On Writ of Certiorari.

BRIEF FOR WALLACE BENEDICT AS RECEIVER AND TRUSTEE IN BANKRUPTCY.

Statement of the Case.

This case comes here by writ of certiorari, issued by this Court on application of Mr. Benedict, to review an affirmance by the Circuit Court of Appeals for the Second Circuit of a decree of the District Court for the Southern District of New York, entered on a petition of Aaron Ratner, directing Mr. Benedict as Receiver in Bankruptcy to account to the petitioner Ratner for all sums collected by the Receiver upon any accounts receivable belonging to the bankrupt corporation mentioned in lists transmitted to Ratner, and directing the bankrupt, or the Trustee in Bankruptcy to execute a formal assignment of the balance of any and all such accounts to Ratner to

the extent of the unpaid advances made by Ratner to the bankrupt and interest thereon; and denying the cross-petition of the Receiver for an order that Ratner pay over to the Receiver the sums received by him on such receivables during the ten days next preceding the filing of the petition in bankruptcy and appointment of the Receiver (Record, pp. 77-78).

The decision on both petition and cross-petition hinged on the validity of a single instrument.

The bankrupt corporation, the Hub Carpet Co., was a family affair, the stockholders including only Albert Lifson, his son Edward A. Lifson, and his two sons-in-law, Fieldman and Abner Ratner (p. 8).

Abner Ratner, who was vice-president of the corporation, and who conducted on its part (pp. 21-27) the arrangements made with the petitioner, Aaron Ratner, which are under review, was Aaron Ratner's son (p. 25).

In May, 1921, Aaron Ratner held a note of the bankrupt for $15,000 which was about to mature (pp. 19, 26). The bankrupt desired to turn this into a more or less permanent loan and to increase the loan, as needed, up to $30,000 (p. 19).

An arrangement was thereupon entered into for executing an assignment of all receivables of the corporation, existing and future, to Ratner as security, for his advances, but with the proviso that, until Ratner should demand payment over to him, the corporation should continue to collect the receivables so assigned in its own name, and use the proceeds in its business, as collected, and for its own purposes, and for keeping the entire transaction hidden.

A document of this general character was accordingly executed and delivered to Aaron Ratner. The instrument was purposely kept secret, and, with Aaron Ratner's consent, the bankrupt corporation went on collecting its receivables and using the proceeds for its own purposes, until about a week prior to the filing of the petition in bankruptcy.

A more detailed story of the situation is as follows:

Under date of May 23rd, 1921, there appears on the corporate (loose leaf) minutes a resolution that the officers were authorized to enter into a written contract to borrow not over $30,000 from Aaron Ratner on the notes of the Company and as security to execute and deliver to Aaron Ratner *"an assignment of the books of account of the Company"* (pp. 10-11).

These minutes bear date just four months and three days before the bankruptcy.

An assignment was produced by Mr. Ratner, unacknowledged, but dated May 23rd, 1921, which is set forth at pages 5-6 of the record.

This instrument purports to assign to Aaron Ratner as collateral security for any sums of money he shall loan to the Company, from time to time, in pursuance of the agreement,

> "all sums of money, accounts and demands "due and owing to us on our books of ac- "count, and such moneys, accounts and de- "mands that will become due and owing to "us, including our books of account, which "may accrue and become due to us in the "future in the ordinary course of business" (p. 5).

and the instrument proceeds to make Aaron Ratner the Company's attorney in fact to collect, sue for or compound these (p. 5).

There follow two paragraphs of the instrument which broadly suggest the contemporaneous arrangement, which constitutes the crux of this case.

The two paragraphs are as follows:

> "We, the Hub Carpet Company, further "covenant and agree to fully disclose our "business and financial conditions at any "time the said Aaron Ratner so demands, "and hereby authorize him to enforce this "assignment at any time that in his judg- "ment it may be for his interest to do so, not- "withstanding the time for the payment of "the notes has not in fact accrued.
>
> "We further covenant and agree with the "said Aaron Ratner on demand to turn over "to the said Aaron Ratner any and all pay- "ments made to us by our debtors and to be "applied by him in payment of any obliga- "tions due him, notwithstanding that the time "for payment of said obligations held by him "at that time has not in fact become due "and payable" (p. 6).

It was admitted by all the parties to that transaction that there was, at the time that instrument was given, a clear and definite oral agreement that the Hub Carpet Company was to go on and collect its receivables and continue to use the proceeds in its own business just as if no assignment had been made, until Mr. Ratner should become disturbed about recovering his claim, and that the receivables should be turned over to him only when he made demand that this should be done (pp. 4, 7-8, 13-14, 15-16, 16-17, 19-21, 22, 23, 27, 29, 30). These are the declara-

tions and testimony of both Ratners, of Fieldman and of young Lifson.

In addition the arrangement that the Hub Carpet Company should go on collecting its receivables and using the proceeds without accounting to Mr. Ratner therefor, was most emphatically carried out (pp. 10, 16, 21, 23, 31).

In May the receivables were between $100,000 and $120,000 (p. 29) and a list of them was handed to Mr. Ratner. Similar lists were handed him monthly, showing changes in the accounts, collections by the Hub Carpet Co. and new receivables (pp. 21, 28-29, 31). The last list, of September 23d, 1921, showed only $89,505.44 of receivables (p. 30).

The changes had been very marked. Between May 24th and September 15th, 1921, the Hub Carpet Company had collected on its receivables, and applied to its own use, over $150,000 (p. 10) or more than five times the amount of Ratner's loan, and all out of accounts claimed as so assigned (or agreed to be assigned), to him. The amount so collected thus largely exceeded the total amount of receivables in existence at the time the document is claimed to have been executed.

Aaron Ratner asserted that he had destroyed all lists sent him prior to that of September 23rd, 1921 (p. 29); and there is nothing in the record to show that any bill or account receivable still outstanding on September 17th, 1921, had any existence on May 23rd, 1921.

As to Ratner's loan, it appeared that the Company owed him $15,000 on a note at the time of executing the assignment of May 23rd, that he took a series of renewal notes for that $15,000 and that in July, 1921, he loaned the Company $15,000

additional, making a total of $30,000 (pp. 19-20, 46, 49).

Up to September 17th, 1921, Aaron Ratner was, as he admitted (pp. 20-21, 23, 27, 31), perfectly aware that the Hub Carpet Co. was collecting its receivables and using the money without accounting to him for it. He made no objection thereto (pp. 16, 20-21, 23, 27, 31). He knew they were selling goods, creating new receivables, and collecting old ones, and buying new merchandise. He knew this, he testified (on examination under Section 21-a) "because that was understood in the agreement" (p. 31) and was necessarily notified of it by the varying lists of receivables sent him (p. 31).

Until September 17th, 1921, Ratner made no move to have any of the receivables or their proceeds turned over to him (pp. 18-19, 20-21, 23, 27, 31, 37).

At that time heavy creditors were holding meetings and pressing the bankrupt for payment (pp. 9, 18-19). Aaron Ratner learned of these things on or before September 17th, 1921, from his son (p. 19). He, however, says he did not infer insolvency from the situation, but only "a difficult period because of slow collections or slow turn-over" (pp. 36-37). Nevertheless, he felt he wanted to put his security in force and went to the officers of the Company on September 17th, 1921, and they agreed to turn over to him the checks that would come in (p. 37). They had already banked their receipts of September 17th (p. 19), but beginning with September 19th, 1921, turned over to Aaron Ratner all their subsequent receipts of checks and notes (pp. 18, 22, 31, 33-34) until bankruptcy supervened just one week later, on September 26th, 1921 (p. 4).

During that week Aaron Ratner received from the Hub Carpet Co. checks and notes aggregating $13,928.12 on which he had already realized $11,581.75 of cash (pp. 33-34).

We call particular attention to three items of testimony given by the two Ratners, showing that there was also deliberate and intentional concealment by both Aaron Ratner and the Hub Carpet Co. of this assignment of receivables.

The son, Abner Ratner, who, on behalf of the bankrupt, made the arrangements for the assignment to his father, testified:

> "We worked out the best way to secure him "without affecting us personally, that is by "not having him collect accounts or anything "of that sort" (p. 19).

and again:

> "We told him that we would not under "any conditions have him make our collec- "tions for us, do you see, and one of the "stipulations was that we were to collect "them" (p. 20).

And Aaron Ratner testified:

> "They told me they wanted, they could "not, it would be kind of compromising them- "selves to be giving away the checks, some- "body *should* collect it, and they could not "do it, so they said they could do it, pro- "viding they made arrangements that they "should be able to keep on collecting the "checks and everything until I will find it "advisable, then I should call it in but as "long as I do not find it advisable in any "way or manner, *nobody should know about "it and they should keep on collecting the "checks.*

"Q. And using the money? A. And using "the money, certainly" (p. 27, as corrected by stipulation, p. 54).

It seems clear that if it becomes known that a business house has assigned all its present and future receivables, the result on the credit of the house is prompt and unmistakable. There is no suggestion that either Aaron Ratner of the corporation ever notified any of the debtors that their accounts had been assigned to Ratner. On the contrary the payments continue coming direct to the Company even after September 17th, 1921, and it merely endorses the checks over to Ratner. The matter was intentionally kept concealed from the Bankrupt's creditors (pp. 19-20, 27). The Company thus actually enjoyed the appearance of owning these accounts, and that it should do so was, admittedly, the deliberate intention of both assignor and assignee.

If the rule in *Russell* v. *Winne*, 37 N. Y. 591, were based on appearance of ownership, there was thus here the full equivalent of any appearance of ownership that could grow out of the possession of chattels; *a fortiori* more than the full equivalent of any appearance of ownership that could grow out of the possession of chattels with a chattel mortgage on them of record.

We have thus a deliberately secret assignment of the receivables of the corporation, present and future, as collateral security, not communicated to the debtors or to the creditors of the assignor, but deliberately concealed from the latter, with an agreement that the assignor should remain in apparent ownership of the receivables and collect and use the proceeds for its own benefit and

without accounting to the assignee therefor, until he should conclude that he was insecure. That arrangement is put in operation and the assignor, before the assignee attempts to secure any of the proceeds, collects out of these assigned receivables, and appropriates to its own use, with the assignee's consent, more than five times the full amount of the assignee's claim.

In addition it appears that the family generally had been active just before the bankruptcy in making preferential transfers to themselves of assets which really belonged to the creditors, forbidden by the law of New York. (Stock Corporation Law, Sec. 66; Vide Appendix A.) The prevalent intent to prefer the family to the general creditors of the bankrupt is obvious (pp. 8-9, 11, 14-15, 23-24).

The petition in bankruptcy was filed and the Receiver appointed, on September 26th, 1921 (pp. 4, 6). On the same day a few hours after the Receiver's taking possession of the bankrupt's store, Abner Ratner handed him a copy of the assignment of the accounts to Aaron Ratner, and later in the day Aaron Ratner came in and admitted the contemporaneous arrangement for the corporation's collecting and using the proceeds of the receivables just as if no assignment had been made, and that this had been done until September 17th, 1921 (pp. 7, 13-14).

Mr. Aaron Ratner, asserting the validity of his assignment, demanded that the receivables be turned over to him by the Receiver (p. 4). The Receiver, deeming the assignment void, demanded that Mr. Ratner surrender to the Receiver, as property of the bankrupt, the moneys and notes received by him under it during the week preceding the bankruptcy (p. 10).

Mr. Aaron Ratner, thereupon instituted the present proceeding on application by petition and order to show cause why the Receiver should not be required to account for what he had already collected and why the accounts should not be formally assigned to Ratner (pp. 3-6).

The Receiver showed cause and cross-petitioned that Ratner be required to turn over to the Receiver what he had received under the assignment during the week preceding the bankruptcy (p. 10).

The District Court and the Circuit Court of Appeals have each held the assignment valid, and that the principle—established by this Court (in *Robinson* v. *Elliott*, 22 Wall, 513), by the New York Court of Appeals (in *Russell* v. *Winne*, 37 N. Y. 591, and many other cases), and by the Circuit Court of Appeals for the Second Circuit (in *In re Leslie-Judge Co.*, 272 Fed. Rep. 886, and many other cases)—that provisions that a chattel mortgagor might, despite the mortgage, go on and sell the mortgaged chattels, and use the proceeds without accounting to the mortgagee therefor, rendered such a chattel mortgage fraudulent and void, was predicated exclusively on the apparent ownership flowing from physical possession of the mortgaged chattels and had no application to assignments of accounts receivable, as to which there could be no such physical possession (pp. 42-44, 55-60).

In accordance with this doctrine, the District Court denied the cross application of the Receiver and ordered him to account to Ratner, for what the Receiver had collected, to the extent of Ratner's claim (p. 45). The Circuit Court of Appeals affirmed this decree (p. 60), on the same theory (pp. 55-60). And its decision is now here for review.

The Hub Carpet Company was adjudicated a bankrupt on October 17th, 1921 (p. 7), and a few days after the entry of the District Court's decree on November 19th, 1921, Mr. Benedict, as appears by the petition for certiorari, became the trustee in bankruptcy as well as Receiver.

The Circuit Court of Appeals, to obviate the objection that the decree of the District Court directed the trustee in bankruptcy who was not, *as such*, a party to the proceeding, to assign the receivables to Ratner (Vide Assignment of Error No. 34, p. 49) treated the Receiver as holding his admitted subsequent capacity as trustee (p. 56). But as the decree directed him as Receiver to account to Ratner for his collections and he had prior to the hearing in the District Court already collected over $18,000, his rights as Receiver are still involved.

Principal Questions Presented.

There is but one principal question presented on this writ, namely:

The doctrine is familiar and well established, both in the Federal Courts and in those of New York that a chattel mortgage, which, either by provision incorporated in the instrument, or by contemporaneous arrangement collateral thereto, is affected by an arrangement that the mortgagor may dispose of the property free from the mortgage and use the proceeds for his own purpose without accounting therefor to the mortgagee, is fraudulent and void as against creditors, even though recorded.

Does that doctrine apply to assignments of accounts receivable? Or is that rule restricted to mortgages or assignments of chattels which are

the subject of manual possession, and without application to assignments of accounts receivable or other choses in action not subject to manual possession?

All other questions presented are merely subordinate elements of this question, brought up as parts of the argument of this one question.

Specifications of Error.

1. The District Court erred in directing the Receiver to account to the petitioner Aaron Ratner for all sums received by him upon any accounts contained in the lists transmitted to Ratner.

2. The District Court erred in directing that the bankrupt or its trustee execute a formal assignment of the balances of such accounts to said Ratner up to the extent of his advances.

3. The District Court erred in sustaining the assignment to Ratner alleged in the petition as a valid instrument.

4. The District Court erred in holding that the assignment to Ratner alleged in the petition was free from fraud.

5. The District Court erred in holding that if the agreement had been that the bankrupt should always substitute assigned accounts up to the value of those in existence on May 23, 1921, the security would have been valid.

6. The District Court erred in holding that the decision in *Robinson* v. *Elliott,* 22 Wallace, 513, rested upon the doctrine of imputed ownership.

7. The District Court erred in holding that the principle of imputed ownership is that on which rests the decision in *Skilton* v. *Codington*, 185 N. Y. 80.

8. The District Court erred in holding that the New York Courts have not definitely declared the basis of their rule that agreements permitting a mortgagor to sell the mortgaged property and apply the proceeds to his own use under the mortgage were fraudulent and void as against creditors.

9. The District Court erred in holding that the rules established by the decisions in *Russell* v. *Winne*, 37 N. Y. 591, *Edgell* v. *Hart*, 9 N. Y. 213, *Potts* v. *Hart*, 99 N. Y. 168, *Haugen* v. *Hachmeister*, 114 N. Y. 566. *Skilton* v. *Codington*, 185 N. Y. 80, *In re Leslie-Judge Co.*, 272 Fed. Rep. 886, and other cases as to the result on a mortgage of allowing the mortgagor, under cover of the mortgage to dispose of the mortgaged property and appropriate the proceeds for its own purposes, were limited in their application to cases of tangible property, and had no application to assigned accounts.

10. The District Court erred in holding that the case of *Sexton* v. *Kessler* could not have been decided as it was except that the property was not chattels.

11. The District Court erred in holding that the case of *Chapman* v. *Hunt* could not have been decided as it was except that the property was not chattels.

12. The District Court erred in holding that the doctrine that allowing the mortgagor under cover of the mortgage to dispose of the mortgaged property and appropriate the proceeds for its own purposes is a fraud and renders the mortgage void depends only upon reputed ownership.

13. The District Court erred in holding that the absence of a provision that the assigned accounts should be kept at a given amount could make no difference.

14. The District Court erred in holding that the assignment of the accounts to the petitioner Ratner set up in the petition was valid as the parties meant it.

15. The District Court erred in holding that the security of such an assignment floats as little when the security is diminished as when it is kept good.

16. The District Court erred in holding that the diminution of the security by the mortgagor's appropriating the proceeds of the mortgaged property to its own use by agreement with the lender contemporaneous with the mortgage is a matter merely between the lender and the borrower.

17. The District Court erred in holding that the monthly transmission to Ratner of lists of existing accounts receivable was an identification of the property assigned.

18. The District Court erred in holding that it did not matter whether the assigned accounts were always to be kept at a given figure.

19. The District Court erred in holding that the monthly transmission of a list of specified accounts to Ratner was the equivalent of a formal assignment of the accounts contained in the list.

20. The District Court erred in holding that there is no local or general law that takes from the transaction the effect it was intended to produce.

21. The District Court erred in failing to hold that the assignment of the accounts to Ratner alleged in the petition was affected by a contemporaneous agreement between the parties thereto that the Hub Carpet Company might collect its receivables, the subject of such assignments, and apply the proceeds to its own use, until such time as the petitioner Ratner should demand turning over the same to him.

22. The District Court erred in failing to hold that said Ratner made no such demand until the 17th day of September, 1921, and that in the meantime the Hub Carpet Company had, after the execution of such assignment, with the consent of said Ratner, collected on such receivables so assigned to him by the instrument in question and applied to its own use over $150,000, being more than four times as much as the total amount of said Ratner's claim.

23. The District Court erred in failing to hold that the Hub Carpet Co. in making the assignment to Aaron Ratner and said Ratner in receiving the same intentionally concealed the same from the persons to whom the Carpet Co. was indebteded.

24. The District Court erred in failing to hold that the arrangement between the Hub Carpet Co. and the petitioner Ratner for subsequent collection of its receivables by the Hub Carpet Co. and its use of the proceeds in its own business was intended by them both, among other purposes, to conceal the assignment from the creditors of the Hub Carpet Co. until said Ratner should demand that such receivables be turned over to him.

25. The District Court erred in failing to hold the assignment of accounts from the bankrupt to Ratner fraudulent and void.

26. The District Court erred in failing to hold that such arrangement for collection of assigned receivables by the Hub Carpet Company and application of the proceeds to its own use made the assignment fraudulent and void as to the creditors of said Hub Carpet Company and this receiver.

27. The District Court erred in failing to hold that by his allowing the Hub Carpet Company to collect and apply to its own use proceeds of the assigned receivables in excess of the total amount of his claim said Ratner had waived and abandoned all right to other receivables under such assignment of the accounts receivable.

28. The District Court erred in failng to hold that in so far as it held the transmissions of lists of accounts and bills receivable in the months of July, August and September, 1921, amounted to assignments of such receivables they were preferential, given to secure antecedent indebtedness, and void as preferential under the four months' rule.

29. The District Court erred in failing to hold that in so far as it held the transmission of a list of accounts and bills receivable in the month of June, 1921, amounted to an assignment of such receivables, it was, as to all then pre-existing indebtedness to said Ratner given to secure antecedent indebtedness and void as preferential under the four months' rule.

30. The District Court erred in refusing to hold that the rule that provisions, contained in or governing any transfer of property as security, that the debtor may dispose of the assigned property and apply the proceeds thereof to his own use, without accounting to the creditor therefor, operate in the most effectual manner to ward off other creditors, and render the transfer fraudulent, and this irrespective of whether the character of the property transferred be tangible or intangible.

31. The District Court erred in refusing to order the said Ratner to return to the Receiver all cash, checks and bills receivable belonging to the Hub Carpet Company received by said Ratner between September 16th and 27th, 1921, by virtue of the assignment set forth in the papers on which the petition and cross-petition of the Receiver were heard.

32. The District Court erred in failing to dismiss on the merits the petition of said Ratner.

33. The District Court erred in denying the cross-petition of the Receiver.

34. The Circuit Court of Appeals erred in affirming the decision of the District Court.

35. The Circuit Court of Appeals erred in holding that there was nothing in the record to warrant even a suggestion of fraud.

36. The Circuit Court of Appeals erred in holding that there was nothing further nor better which could have been done by the parties to perfect Ratner's lien or to reduce to possession what the parties had called the collateral security, than the delivery of a list of the accounts to Ratner.

37. The Circuit Court of Appeals erred in holding that the American doctrine of reputed ownership does not apply to choses in action.

38. The Circuit Court of Appeals erred in holding that it is matter of common knowledge that the merchant utilizes his accounts receivable and other kinds of choses in action to keep his business liquid, and every one expects that he may sell or pledge such choses in action for that very purpose.

39. The Circuit Court of Appeals erred in holding that it is mainly because of commercial usages and necessities that the courts have not included accounts receivable within the doctrine of ostensible ownership, but on the contrary have excluded them therefrom.

40. The Circuit Court of Appeals erred in holding that underlying such cases as the decisions of this Court in *Sexton* v. *Kessler,* 225 U. S. 90, and *Grey* v. *Dockendorff,* 231 U. S. 513, and the decision in *Chapman* v. *Hunt,* 254 Fed. Rep.

768, is the principle of exclusion from the reputed ownership rule.

41. The Circuit Court of Appeals erred in holding that the principle of exclusion from the rule was applicable to this case.

42. The Circuit Court of Appeals erred in holding that the principles stated in the opinion of Nash, J., in *Stackhouse* v. *Holden,* 66 App. Div. 423, were applicable to the case at bar.

43. The Circuit Court of Appeals erred in holding that the Receiver (now Trustee) must account and pay over to Ratner any and all proceeds representing collections by the Receiver or Trustee of the debts set forth in the list of September 23, 1921, and on all prior lists up to an amount sufficient to pay the balance beyond $11,581.78, with appropriate interest.

44. The Circuit Court of Appeals erred in holding that the decree of the District Court properly provided that the bankrupt or its Trustee should execute a formal assignment to Aaron Ratner of the accounts not yet collected.

45. The Circuit Court of Appeals erred in directing that the decree of the District Court be affirmed.

Brief of the Argument.

The question presented by this case is an extremely simple one based on facts practically undisputed and is this:

The rule is well established, both in the Federal Courts and in the Courts of the State of New York, that a chattel mortgage, containing a provision that the mortgagor may dispose of the property and use the proceeds for his own purposes, without accounting to the mortgagee, is fraudulent and void as against creditors, even though it be recorded.

> *Robinson* v. *Elliott,* 22 Wall. 513;
> *In re Leslie Judge Co.,* 272 Fed. Rep. 886;
> *In re Volence,* 197 Fed. Rep. 232;
> *Russell* v. *Winne,* 37 N. Y. 591;
> *Skilton* v. *Codington,* 185 N. Y. 80, 90;
> *Zartman* v. *First National Bank,* 189 N. Y. 267.

The principle applies equally whether the provision be incorporated in the instrument or collateral thereto.

> *Frost* v. *Warren,* 42 N. Y. 204;
> *Gardner* v. *McEwen,* 19 N. Y. 123.

Does this doctrine apply exclusively to the case of mortgages of tangible property, the subject of manual possession, left in the possesion of the owner, or will it apply also to the assignment exclusively of receivables, present and future, for purposes of collateral security?

The Courts below have acted that the rule is predicated on the appearance of ownership flowing from physical possession, and that there can be no such appearance of ownership flowing from

possession in the case of receivables, because they are not the subject of manual possession.

The evidentiary facts were undisputed and the question is practically one of law.

The resultant rule adopted by the Courts below, is of the most widespread interest in the commercial world. We believe it to be in flat contradiction of the doctrines announced by this Court in *Robinson* v. *Elliott,* where, in stating that principle, this Court apparently did not derive it from any matter of appearance of possession, but from the inherent duplicity of such an instrument, valid as a mortgage against the mortgagor's creditors when the debtor wants it to be, and of no validity when he wants to use the proceeds himself; and we understand the decisions of the New York Court of Appeals to hold that same doctrine.

The District Court, as we have seen, took an opposite view, holding that the assignment was not fraudulent but valid, on the ground that the rule, that such arrangements are fraudulent and void as against creditors, is predicated exclusively on appearance of ownership flowing from physical possession of the property (pp. 42-44) and directed the receiver and trustee to turn over the receivables to the claimant, Mr. Ratner, to an amount sufficient to satisfy his claim, sustaining that claim as a prior lien (p. 45).

That decision was unanimously affirmed by the Circuit Court of Appeals on the same ground (pp. 55-60); the court holding that though the agreement would have rendered the assignment void had it been one of tangible property, it had no such effect on an assignment of receivables not susceptible of manual possession.

POINT I.

A contemporaneous agreement that despite an assignment of property as collateral security to secure the assignee for a debt due him from the assignor, the assignor may continue to use and dispose of the property as his own, retaining and using the proceeds in his business, without accounting therefor in any way to his assignee, renders the assignment fraudulent and void as against creditors, not only in the case of ordinary chattel mortgages but also in the case of assignments confined to accounts receivable.

In re Leslie-Judge Co., 272 Fed. Rep. 886;
Russell v. *Winne*, 37 N. Y. 591;
Skilton v. *Codington*, 185 N. Y. 80, 90-92;
Griswold v. *Sheldon*, 4 N. Y. 581, 588-590;
Southard v. *Benner*, 72 N. Y. 424, 431;
Zartman v. *First Natl. Bank*, 189 N. Y. 267;
In re Volence, 197 Fed. Rep. 232;
Robinson v. *Elliot*, 22 Wall, 513, 525, 527.

We think an examination of these cases, and others, shows clearly that the basic principle of this rule is not predicated on any appearance of ownership of the property growing out of its

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We think an examination of these cases, and others, shows clearly that the basic principle of this rule is not predicated on any appearance of ownership of the property growing out of its

physical possession, but on the two-faced character of the instrument, making it a shield of the debtor's property against his other creditors, while leaving it no obstacle to the debtor's using his property as he will; and on the fact that an instrument so qualified is not a real security, but is intended for ulterior and fraudulent purposes and operates in fraud of creditors.

It seems to us that the learned courts below have confused two independent principles, though frequently both apply to a single transaction. There is *one* rule that *is* based on such appearance of ownership growing out of continued possession. It is the familiar one, now limited by statutes, that *unrecorded* chattel morgages are void (in many states only against creditors or purchasers *without notice*) where the mortgagor remains in continued possession. *That* statutory rule unquestionably found its origin in the fact that the mortgagor is clothed by possession with a fallacious appearance of title. And provisions for recording chattel morgages were devised to remove that appearance and to cure that defect by giving notice, while saving the advantages of honest mortgages.

Robinson v. *Elliott*, 22 Wall., 513, 523.

For the New York statute providing for recording chattel mortgages Vide Appendix C.

Decisions holding that such agreements as we are here considering do avoid mortgages, even though they be recorded in accordance with the statute, and even though the mortgagee takes and holds possession of the property, can not rest on any such principle of apparent ownership, growing out of physical possession, for that appearance is prevented by the recording of the instrument,

and must rest on some other and different basic principle, not cured by preventing that appearance.

Cases implying that the rule is not based on any appearance growing out of possession but on the fraudulent character of the arrangement we find in abundance.

Robinson v. *Elliott,* 22 Wall. 513, 525-527;
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Vilas Bank v. *Newton,* 25 A. D. 62, 66;
Mittnach v. *Kelly,* 3 Abb. Ct. App. Dec. 301;
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Paget v. *Perchard,* 1 Esp. 205.

And we find in many of these cases statements of a totally different principle, as the basis of the rule here invoked—one susceptible of no such distinction as the courts below have drawn.

In the leading New York case it was said:

> *"If there is an agreement by the mortgagee that the mortgagor may sell or dispose*

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In the leading New York case it was said:

> *"If there is an agreement by the mortgagee that the mortgagor may sell or dispose*

of any of the property for his own benefit, it is established, conclusively, that the mortgage was given for some purpose other than that of securing a debt to the mortgagee, or of giving him any real interest in such property. It is evident that, as to such property, the mortgagee not having any real interest therein, such real interest remains in the mortgagor. Why, then, is the mortgage given upon such property? Evidently the better to enable the mortgagor to enjoy the benefit thereof, at the expense of creditors. Were there no creditors of the mortgagor, there would be no object in giving or taking mortgages accompanied with such an agreement. It is, I think, clear that *such an agreement shows that the mortgage was not made in good faith and without a design to hinder creditors.* There is no question of intention to be submitted to a jury. It already appears that, as to such property, the mortgage was not designed by the parties as an operative instrument between them; and its only operation must be to the prejudice of others. *The court should as to such property, pronounce it void, for the reason that the evidence conclusively shows it fraudulent.*"

Russell v. *Winne*, 37 N. Y. 591, 594-595.
Vide Appendix D for provisions of the New York Statute of Frauds.

This, we believe, states the real principle back of the rule we have invoked. It leaves no room for any such distinctions as the judges below have drawn between tangible and intangible property. Sheltering intangible property for the debtor, enabling him to dispose of it, is just as fraudulent and just as prejudicial as the like duplicity with regard to tangible property.

The leading case in this Court is *Robinson* v. *Elliott*, 22 Wall. 513.

As we read the opinion in that case, this Court there declared the mortgage in question void on *two independent grounds,* the first, the fraudulent appearance of ownership, the second, expressly pointed out by the use of the words "apart from this" as a wholly independent ground, that the mortgage permitted the mortgagors under cover of the mortgage, to fend off creditors from seizing the property and at the same time to sell the goods and appropriate the proceeds as their own.

We may be permitted to quote two extensive passages from the opinion, as the Courts below have given to them a construction entirely opposite, as it seems to us, to what this Court declared in that case.

At page 523 this Court said:

> "If chattel mortgages were formerly, in most of the States, treated as invalid unless actual possession was surrendered to the mortgagee, it is not so now, for modern legislation has, as a general thing (the cases to the contrary being exceptional) conceded the right to the mortgagor to retain possession, if the transaction is on good consideration and bona fide. This concession is in obedience to the wants of trade, which deem it beneficial to the community that the owners of personal property should be able to make bona fide mortgages of it, to secure creditors, without any actual change of possession.
>
> *"But the creditor must take care in making his contract that it does not contain provisions of no advantage to him, but which benefit the debtor, and were designed to do so, and are injurious to other creditors. The law will not sanction a proceeding of this kind. It will not allow the creditor to make use of his debt for any other purpose than*

his own indemnity. If he goes beyond this, and puts into the contract stipulations which have the effect to shield the property of his debtor, so that creditors are delayed in the collection of their debts, a court of equity will not lend its aid to enforce the contract."

And at pages 525-526 this Court added:

"Manifestly it was executed to enable the mortgagors to continue their business and appear to the world as the absolute owners of the goods, and enjoy all the advantages resulting therefrom. It is idle to say that a resort to the record would have shown the existence of the mortgage, for men get credit by what they apparently own and possess, and his ownership and possesion had existed without interruption for ten years. There was nothing to put creditors on their guard. On the contrary, this long-continued possession and apparent ownership were well calculated to create confidence and disarm suspicion.

But, APART FROM THIS, security was not the leading object. If so, why does Mrs. Sloan's note remain overdue for twenty-one months, and why does Robinson continue to indorse? This conduct is the result of trust and confidence, which as Lord Coke tells us, are ever found to constitute the apparel and cover of fraud.

In truth, the mortgage, if it can be so called, is but an expression of confidence, for there can be no real security where there is no certain lien.

Whatever may have been the motive, which actuated the parties to this instrument, it is manifest that the necessary result of what they did do was to allow the mortgagors under cover of the mortgage, to sell the goods as their own, and appropriate the proceeds to their own purposes; and this, too, for an

indefinite length of time. A mortgage which, in its very terms, contemplates such results, besides being no security to the mortgagees, operates in the most effectual manner to ward off other creditors; and where the instrument on its face shows that the legal effect of it is to delay creditors, the law imputes to it a fraudulent purpose."

Robinson v. *Elliott,* 22 Wall. 513, 523, 525-526.

We find nothing in that case that intimates that appearance of ownership growing out of visible possession is necessary to give to such an arrangement that effect to delay creditors which renders it fraudulent.

The only other case that seems to call for attention is the decision in *Stackhouse* v. *Holden,* 66 A. D. 423, a three to two decision in the Appellate Division of the Fourth Department of the State of New York. That Court is, of course, an intermediate Court of Appeal and the decision cannot be regarded as settling the law for the State of New York, especially when it is in conflict with the cases in the Court of Appeals which we have cited. We call attention to the dissent in *Stackhouse* v. *Holden,* of Justices Spring and Adams, and to the vigorous statement in the dissenting opinion, following exactly the lines of the decision of this Court in *Robinson* v. *Elliott.*

"The vice here is that there was in fact no real transfer, no real vesting of title in the assignee. It was an arrangement whereby the title and authority of Humphrey & Holdridge were to be unrestricted as long as they were able to shunt along their business, but whenever the inevitable crash came, then, by

some sort of legerdemain, the written instrument was to be stimulated into life to prefer the overdraft of the defendant. *A transfer which at one time places no bar to the ownership of the assignor, and in another exigency is intended to be absolute, cannot be upheld against the creditors who are seeking an equal distribution of all the assets of the bankrupt assignors.*"

Stackhouse v. *Holden,* 66 A. D. 423, 433.

The case was not appealed to the Court of Appeals, but, as the writer is informed, was settled by a compromise, after this decision by the Appellate Division.

The last quoted sentence from the opinion of Justice Spring states in other words the principle contended for us, and which we have regarded as announced by this Court in *Robinson* v. *Elliott;* that the fraudulent character of such an agreement, that the mortgagor may continue to sell the property without accounting for the proceeds to the mortgagee, is not derived from any manner or appearance of possession, but from the inherent duplicity of such an instrument, which is valid as a mortgage against his creditors when the debtor wants to shield his property from them, and of no binding force when he wants to use the proceeds himself. The decision in *Stackhouse* v. *Holden,* is in flat conflict with the principles laid down in the following cases:

Robinson v. *Elliott,* 22 Wall. 513;
Blennerhasset v. *Sherman,* 105 U. S. 100;
Russell v. *Winne,* 37 N. Y. 591;
Southard v. *Benner,* 72 N. Y. 424, 431;
Skilton v. *Codington,* 185 N. Y. 80, 90-92.

POINT II.

The decisions in *Sexton* v. *Kessler*, 225 U. S. 90, and in *Chapman* v. *Hunt*, 254 Fed. Rep. 768, in no way conflict with the rule we invoked.

In *Sexton* v. *Kessler*, 225 U. S. 90, there was no such feature as exists here of allowing the pledgor to withdraw pledged securities, without substituting therefor other securities of equal or greater value, not previously included in the pledge.

This Court expressly distinguished from that case two New York cases, holding that the security would fail where the mortgagor retained full power to replace or not as he saw fit, and pointed out that in the case before it there "was a "more limited and cautious dealing giving an abso- "lute present right, qualified only by possible sub- "stitution and perhaps by a right of partial with- "drawal if the remaining securities had risen suf- "ficiently in value" (225 U. S. 98).

In the case at bar every receivable might have been collected and the proceeds used, without any new receivable arising.

Moreover, if any new receivable did arise and were assigned it would not constitute a substitution of new collateral for old, for by the very terms of the instrument it was to be included on its own account, irrespective of any collections having been made. Nor was there even any agreement to keep the receivables up to an amount equal to the original amount.

The other case, *Chapman* v. *Hunt,* 254 Fed. Rep. 768, likewise contained the vital feature that only certain specific accounts of limited amount were assigned to Hunt as collateral, and the Candy Works was permitted to receive the proceeds of any such assigned account only "upon assigning "to Hunt an equal amount of new accounts, so "that he should be always secured in the sum of "$6,000."

There was there no such situation of a general leave to the assignor to collect and use the proceeds of the assigned receivables, irrespective of replacement or substitution of others in their place, and without new consideration or provision for any new substituted security whatever.

In both the *Sexton* and the *Hunt* cases there was the vital feature of a new consideration for the withdrawal, and neither transaction bore the two faced character of *not* being an assignment when the assignor wanted to use the property, and being one when his creditors wanted to take the property.

Neither case is parallel to the present. Neither case opened the door to the innumerable frauds to which the decision below throws all doors open.

POINT III.

Even were the rule predicated on a false appearance of ownership, the facts here supply the equivalent, and more than the equivalent, of any false appearance of ownership arising from possession of tangibles. There was the actual appearance of ownership deliberately preserved and sustained, and deliberate concealment of the assignment to avoid the obvious and contemplated consequences of disclosure of the fact of the assignment of all receivables present and future.

In the statement of facts we have called attention to the testimony of Ratner to the specific discussion, in the original transaction, of the purpose that the existence of the assignment should not become known.

Young Ratner, who acted for the Hub Carpet Co. in the transaction, testified:

> "We worked out the best way to secure him *without affecting us personally,* that is, by not having him collect accounts or anything of that sort" (p. 19).
>
> "We told him that *we would not under any conditions have him make our collections for us,* do you see, and one of the stipulations was that we were to collect them" (p. 20).

And the petitioner Ratner himself testified:

> "They told me they wanted, they could not, it would be kind of compromising themselves, to be giving away the checks, somebody should

collect it and they could not do it; so they said that they could do it providing they made arrangements that they should be able to keep on collecting the checks and everything until I will find it advisable, then I should call it in, *but as long as I do not find it advisable in any way or manner nobody should know about it and they should keep on collecting the checks.*

"Q. And using the money? A. And using the money, certainly" (p. 27 as corrected by stipulation at p. 54).

The Court needs no information as to the immediate consequences to a business house of having the fact become known that it had assigned all its receivables present and future as collateral.

Those consequences these parties deliberately tried to avoid by keeping the assignment secret, allowing the Hub Carpet Co. to go on collecting its receivables and using the proceeds in its business.

It is not to be forgotten that Ratner Senior is here as a plaintiff in equity seeking the affirmative relief of having the accounts turned over to him. He nowhere suggests that there is any entry on the books of the bankrupt of the assignment of the accounts to him. He admits on the contrary that there was here, not only the casual secrecy of a transaction in receivables such as Justice Nash referred to in *Stackhouse* v. *Holden,* 66 A. D. 453, but direct, active concealment, and *expressed* intention on the part of both parties that *"nobody should know about it"* (p. 27). This implies that the assignment was not entered on the books, and that it was intended, by both the bankrupt and Ratner, that the bankrupt should

continue in business as the ostensible owner of its receivables, free from encumbrance, and have continued credit on the standing of that apparent ownership—a fraudulent appearance if the assignment be sustained.

To-day every credit man of a wholesale house examines the statements of a buyer to see what his assets and liabilities are, and the item of bills and accounts receivable is always one of the most important items on which an extension of credit is based. The stock of goods and the receivables are the liquid assets. The merchant of today has quite as much appearance of ownership of his receivables as he has of goods stored in warehouse, and on his appearance of ownership of his receivables he obtains credit quite as much as on his appearance of owning goods which may perhaps be stored in a dozen different public warehouses, and of which his ostensible possession is practically limited to his possession of warehouse receipts.

Mr. Ratner in this case admits that both he and the bankrupt deliberately arranged that nobody should know about it (p. 27) and there is not a suggestion that any one did know about it until after the appointment of the receiver. The debtors of the bankrupt were not notified of the assignment of the claims against them and the bankrupt's creditors were kept in ignorance of it. Even the sums Ratner actually received all came into the physical possession of the bankrupt and even during the last week, when they were turned over by it to Ratner in the form of checks or notes, the collection by the bankrupt was kept up.

The whole situation from start to finish was one of deliberate, active concealment by both Ratner

and the bankrupt, and that active concealment was essentially fraudulent.

There was ostensible ownership by the bankrupt of its receivables and that appearance was deliberately assisted by Ratner.

The Circuit Court of Appeals says:

> "There was nothing further nor better "which could have been done by the parties "to perfect Ratner's lien or to reduce to pos- "session what the parties had called the 'col- "lateral security.'
>
> "There was no way by which Hub Co. could "physically deliver notes, checks or other evi- "dences of debt from customers which had "not yet been received, and the only prac- "ticable method of conferring title and "possession was by the delivery of the list "in compliance with the demand of Septem- "ber 17, as contemplated by the agreement "of May 23" (p. 57).

Neither of these statements appears to us sound.

As to the first of these two paragraphs, we see two things that could have been done, and which the bar has generally regarded as important in such cases.

(1) The transfer of the accounts could have been entered on the account books of the bankrupt.

(2) Notice of the assignment of each claim could have been sent to the debtor requiring him to pay the assignee. Such notices are recognized as important for the purpose of protecting a *bona fide* assignee by the New York statute. (Civil Practice Act, N. Y., Sec. 267, Subd. 1; *Vide* Appendix B).

But either of these steps would have tended to frustrate the purpose of concealment.

As to the second paragraph, had the assignment been unaffected by the special agreement, the first receivables collected would have been turned over to Ratner at once when received. Instead, over $150,000 was collected thereon and used by the bankrupt with Ratner's knowledge and consent.

Physical possession of corporeal property is not the only method of giving an appearance of ownership. The opinions below have assumed the contrary. Even if the doctrine of reputed ownership were applicable, this doctrine should not be restricted to one special form of appearance of ownership, especially where the appearance of reputed ownership has been deliberately and intentionally created and fostered by both the bankrupt and the claimant under a secret transfer, purposely kept concealed.

By concealing the assignment they staved off bankruptcy till three days more than four months after the execution of the assignment.

If possession of chattels giving an appearance of ownership is a material factor of the rule we have invoked, the deliberate and intentional arrangement that the Hub Carpet Co. should go on collecting its receivables and using them in its business for the express purpose of preventing any information of the assignment leaking out, is its full legal equivalent.

If the constructive representation of continued ownership growing out of continued possession of tangibles furnishes a needed element in the one case, is its place not fully taken in the other by deliberate concealment of the assign-

ment and continued collection of the receivables by the assignor with the express purpose of conveying the impression that there had been no assignment? Any one can see that the Hub Carpet Co. maintained its credit after May 23rd, 1921, only by the appearance of owning its receivables.

Is there not here the full equivalent of every element of fraud suggested in *Robinson* v. *Elliott*, 22 Wall. 513, and in *Blennerhasset* v. *Sherman*, 105 U. S. 100? And is not this assignment fraudulent and void at common law?

POINT IV.

If the assignment was galvanized into actuality by Ratner's taking over the checks as they came in, during the last week before the bankruptcy, that galvanization process went no further than his actual receipts of about $12,000, and the decree for further payment to him of some $18,000 is erroneous. Moreover as to the $12,000 the transaction was preferential.

POINT V.

The main question presented is of the utmost importance to the business community and to the administration of the Bankruptcy Act.

If the decision below correctly states the law, the effect on the credit department of every business house is going to be immediate. No credit man can know what reliance to place upon statements of assets and liabilities. They may be subject to all sorts of concealed assignments of the receivables, which notably constitute a most important item of quick assets, on which allowances of credit are based. The decision below opens the door wide for successful fraud.

As an actual fact under modern business conditions, especially in large cities, where stocks of goods are carried in warehouses and represented only by warehousemen's receipts, there is just as much appearance of possession and ownership in the case of receivables as there is in the case of tangible property in storage.

No reason is seen why a shelter that is fraudulent as to one kind of property because it is an assignment when the assignor wants it to be an assignment and not an assignment when he doesn't want it to be, is not just as much a fraud as to another kind of property.

> "The law will not sanction a proceeding of this kind. It will not allow the creditor to make use of his debt for any purpose other than his own indemnity. If he goes beyond this, and puts into the contract stipulations which have the effect to shield the property of his debtor so that creditors are

delayed in collection of their debts, a court of equity will not lend its aid to enforce the contract."

Robinson v. *Elliott,* 22 Wall. 513, 523.

"Whatever may have been the motive which actuated the parties to this instrument, it is manifest that the necessary result of what they did do was to allow the mortgagors under cover of the mortgage, to sell the goods as their own, and appropriate the proceeds to their own purposes; and this, too, for an indefinite length of time. A mortgage which, in its very terms, contemplates such results, besides being no security to the mortgagees, operates in the most effectual manner to ward off other creditors; and where the instrument on its face shows that the legal effect of it is to delay creditors, the law imputes to it a fraudulent purpose."

Robinson v. *Elliott,* 22 Wall, 513, 523, 525-526.

The decision below conflicts with those statements of the law, and with the repeated declaration of the law by the New York Court of Appeals.

Russell v. *Winne,* 37 N. Y. 591;
Skilton v. *Codington,* 185 N. Y. 80, 90-92;
Southard v. *Benner,* 72 N. Y. 424, 431;
Griswold v. *Sheldon,* 4 N. Y. 581, 588-591.

The arrangement made in this case had precisely the characteristics described in all these cases as constituting fraud on creditors.

POINT VI.

The decrees under review should be reversed and decree ordered directing that Ratner pay over to Mr. Benedict, as Receiver and Trustee, the sums collected by Ratner on the receivables; and the application by Ratner that the receiver account to him should be denied.

SELDEN BACON,
Counsel for Wallace Benedict
as Receiver and as Trustee.

APPENDIX.

A.

Sec. 66. New York Stock Corporation Law.

Section 66. No corporation which shall have refused to pay any of its notes or other obligations, when due, in lawful money of the United States, nor any of its officers or directors, shall transfer any of its property to any of its officers, directors or stockholders, directly or indirectly, for the payment of any debt, or upon any other consideration than the full value of the property paid in cash. No conveyance, assignment or transfer of any property of any such corporation by it or by any officer, director or stockholder thereof, nor any payment made, judgment suffered, lien created or security given by it or by any officer, director or stockholder when the corporation is insolvent or its insolvency is imminent, with the intent of giving a preference to any particular creditor over other creditors of the corporation, shall be valid, except that laborers' wages for services shall be preferred claims and be entitled to payment before any other creditors out of the corporation assets in excess of valid prior liens or incumbrances. No corporation formed under or subject to the banking, insurance or railroad law shall make any assignment in contemplation of insolvency. Every person receiving by means of any such prohibited act or deed any property of the corporation shall be bound to account therefor to its creditors or stockholders or other trustees. No stockholder of any such corporation shall make any transfer or assignment of his stock therein to any person in contemplation of its insolvency. Every transfer or assignment or other act done in violation of the foregoing provisions of this section shall be void. No conveyance, assignment or transfer of any property of a corporation formed under or subject to the banking law, exceeding in value one thousand dollars, shall be made by such cor-

poration, or by any officer or director thereof, unless authorized by previous resolution of its board of directors, except promissory notes or other evidences of debt issued or received by the officers of the corporation in the transaction of its ordinary business, and except payments in specie or other current money or in bank bills made by such officers. No such conveyance, assignment or transfer shall be void in the hands of a purchaser for a valuable consideration without notice. Every director or officer of a corporation, who shall violate or be concerned in violating any provisions of this section, shall be personally liable to the creditors and stockholders of the corporation of which he shall be director or an officer to the full extent of any loss they may respectively sustain by such violation.

B.

Sec. 267. New York Civil Practice Act.

Sec. 267. Rules respecting the allowance of counterclaims.

The counterclaim, specified in subdivision second of the last section, is subject to the following rules:

1. If the action is founded upon a contract which has been assigned by the party thereto, other than a negotiable promissory note or bill of exchange, a demand existing against the party thereto or an assignee of the contract at the time of the assignment thereof, and belonging to the defendant, in good faith, before notice of the assignment, must be allowed as a counterclaim to the amount of the plaintiff's demand, if it might have been so allowed against the party, or the assignee, while the contract belonged to him.

2. If the action is upon a negotiable promissory note or bill of exchange which has been assigned to the plaintiff after it became due, a demand existing against a person who assigned

or transferred it after it became due must be allowed as a counterclaim to the amount of the plaintiff's demand, if it might have been so allowed against the assignor while the note or bill belonged to him.

3. If the plaintiff is a trustee for another, or if the action is in the name of a plaintiff who has no actual interest in the contract upon which it is founded, a demand against the plaintiff shall not be allowed as a counterclaim; but so much of a demand existing against the person whom he represents, or for whose benefit the action is brought, as will satisfy the plaintiff's demand, must be allowed as a counterclaim, if it might have been so allowed in an action brought by the person beneficially interested.

C.

New York Lien Law, Section 230.

§ 230. Chattel mortgages to be filed. Every mortgage or conveyance intended to operate as a mortgage of goods and chattels or of any canal boat, steam-tug, scow or other craft, or the appurtenances thereto, navigating the canals of the state, which is not accompanied by an immediate delivery, and followed by an actual and continued change of possession of the things mortgaged, is absolutely void as against the creditors of the mortgagor, and as against subsequent purchasers and mortgagees in good faith, unless the mortgage, or a true copy thereof, is filed as directed in this article. This article shall not apply to agreements creating liens upon merchandise or the proceeds thereof for the purpose of securing the repayment of loans or advances made or to be made upon the security of said merchandise and the payment of commissions or other charges provided for by such agreement, where the conditions specified in section forty-five of the personal property law are complied with, nor shall this article apply to the mortgage or pledge of or lien upon

stocks or bonds mortgaged or pledged to secure payment of a loan, which stocks or bonds, by the terms of a written instrument creating such mortgage, pledge or lien and setting forth the conditions of such loan, are to be delivered to the lender on the day such loan is made, and every such mortgage, pledge or lien, of such securities, shall be valid as against creditors of such mortgagor or pledgor, provided, however, that if such securities are not delivered to the pledgee or mortgagee on the day such loan is made, the mortgage, lien or pledge therein intended to be created shall be absolutely void and of no effect as against the creditors of such mortgagor, pledgor or lienor unless such instrument, or a true copy thereof, is filed as directed in this article, on the day following the making of such loan, and provided also that every such mortgage, pledge or lien shall be absolutely void as against purchasers, pledgees or mortgagees in good faith of such stocks or bonds provided such stocks or bonds are delivered to such purchaser, pledgee or mortgagee at the time of such purchase, pledge or mortgage.

D.

New York Statute of Frauds.
(Personal Property Law.)

§ 30. Definitions. As used in this article, the term "transfer" includes sale, assignment, conveyance, deed and gift, and the term "agreement" includes promise and undertaking.

§ 35. Transfers and charges with fraudulent intent. Every transfer of any interest in personal property, or the income thereof, and every charge on such property or income, made with the intent to hinder, delay or defraud creditors or other persons of their lawful suits, damages, forfeitures, debts or demands, and every bond or other evidence of debt given, suit commenced, or decree or judgment suffered, with such intent, is void as against every person so hindered, delayed or defrauded.

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IN THE

Supreme Court of the United States

OCTOBER TERM—1922.

No. 49 //

WALLACE BENEDICT, as Receiver in Bankruptcy of The Hub Carpet Company,
Appellant,
against
AARON RATNER,
Appellee.
(On Writ of Certiorari.)

BRIEF IN REPLY.

The brief for the Appellee contains but little not covered by the brief for Benedict already filed. We may, however, give brief attention to certain cases which have been cited by the Appellee, apparently in the belief that they bear weighily on the question here presented.

In *Union Trust Co.* v. *Bulkeley*, 150 Fed. 510, it was pointed out by the trustee in bankruptcy that the bankrupt had collected some of the assigned accounts and used the proceeds in his business; but the District Judge specifically pointed out that these acts were "*not* chargeable to the petitioner, nor, so far as the testimony shows, known to or even suspected by him" (150 Fed. 510, 514). The Circuit Court of Appeals made no reference to that feature of that case.

So far from that decision being in point, that statement indicates that it was considered in that case that, had the petitioner there been a party to any such arrangement as is here fully shown to have been directly joined in and fully participated in by the appellee, a totally different case would have been presented for consideration. The case distinguishes itself.

Re Michigan Furniture Co., 249 Fed. 978, is a case decided by the same District Judge (Hon. Learned Hand) before whom the present case originally came.

In *Greey* v. *Dockendorff*, 231 U. S. 513, there was no such arrangement by which the assignor was at liberty to collect and use the proceeds in his business, without paying the loan.

Moreover, in that case, this Court pointed out that "There was no active concealment and no attempt to mislead any one interested to know the truth" (231 U. S. 516). Here on the contrary there was the deliberate arrangement that the assignment must be so arranged and managed that "nobody should know about it" (Record, p. 27, side page 48; vide stipulated correction at page 54, side page 94, b), in addition to the arrangement that the bankrupt might go on, as it did, and collect the secretly assigned accounts, and use the proceeds in its own business (ibidem).

The case of *Sexton* v. *Kessler*, 225 U. S. 90, as has been already pointed out both by us and by the Circuit Court of Appeals (p. 59), is not in point.

In an equity case the whole determination below is, of course, open for review here, both as to the facts and as to the law. And the statement of

the Circuit Court of Appeals that "there is nothing in this record to warrant even a suggestion of fraud" (p. 56) does not conclude this court, especially where the evidentiary facts are admitted and the question is whether admitted acts and concealment constitute fraud.

cf. *Russell* v. *Winne*, 37 N. Y. 591, 594-595;
Frost v. *Warren*, 42 N. Y. 204.

That accounts receivable are not chattels, or within the provisions for record of chattel mortgages, is unquestioned.

On the fundamental point in the case,—that the vice in an assignment of accounts as security which is affected by an arrangement that the assignor may continue to collect the accounts and use the proceeds himself without paying the claim they are assigned to secure, arises from the two-fold character of the instrument, and not from the fact of apparent possession,—the long array of authorities that accounts receivable are not chattels, cited by the appellee, sheds no additional light.

The effect of continued possession of chattels is, under the New York recording act, completely obviated by recording a chattel mortgage. But it remains void none the less though recorded, if it is affected by an arrangement that the mortgagor may sell and use the proceeds in his business, without accounting to the mortgagee.

Zartman v. *First National Bank*, 189 N. Y. 267;
In re Leslie Judge Co., 272 Fed. 886;
Robinson v. *Elliott*, 22 Wall. 513, 521.

Indeed the Zartman case strongly supports in an additional way our theory that the rule (that such agreements that the mortgagor may sell and use the proceeds himself for his own purposes renders a chattel mortgage void) is not predicated on imputed ownership arising out of continued possession of chattels by the mortgagor, as held by the courts below, for it lays down that rule as applicable as well to mortgages of realty as to those of personalty.

Zartman v. *First National Bank,* 189 N. Y. 267.

What special quality is there in accounts receivable that differentiates them from *all* other property even incorporeal hereditaments, when it comes to a question of fraud on creditors?

In the *Leslie Judge* case the Circuit Court of Appeals in New York held that a trust deed (or mortgage) covering both chattels and intangibles was void as to the intangibles as well as to the chattels, because it permitted the mortgagor to sell and use the proceeds of only such of the *chattels* as might become useless as part of its plant.

In re Leslie Judge Co., 272 Fed. 886.
Certiorari refused.
Green v. *Felder,* 256 U. S. 704.

It is not easy on any principlesgoverning *fraud* to distinguish that case from the present one.

An arrangement by which the assignor can go on collecting the assigned accounts and using the proceeds in his business as he pleases, without paying off the claim to secure which the accounts are assigned, as this court pointed out in *Robinson* v. *Elliott* (22 Wall. 513, 521), has a different purpose than mere security, and tends to hinder,

delay and defraud the creditors of the assignor in the collection of their debts. It is intended to be an assignment when creditors seek to realize, and *not* to be one when the bankrupt wants to use the property for his own purposes. That duplicity of intent destroys its good faith and makes it fraudulent.

Robinson v. *Elliott*, 22 Wall. 513, 521;
Russell v. *Winne*, 37 N. Y. 591, 594-595.

So viewed, what difference does it make whether the property so dealt with consists of chattels, or notes, or accounts receivable?

Respectfully submitted,

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Counsel for Appellant.